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UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Competitive Product Prices
Inbound Competitive Multi-Service Agreements with
Foreign Postal Operators
China Post Group–United States Postal Service
Bilateral Agreement (MC2010-34)
Negotiated Service Agreement

Docket No. CP2013-23

PUBLIC REPRESENTATIVE COMMENTS ON POSTAL SERVICE NOTICE CONCERNING ADDITIONAL INBOUND COMPETITIVE MULTI-SERVICE AGREEMENT WITH FOREIGN POSTAL OPERATORS 1 NEGOTIATED SERVICE AGREEMENT (WITH CHINA POST GROUP)

(December 12, 2012)

The Public Representative hereby provides comments pursuant to Order No. 1562.[1] In that Order, the Commission established the above referenced docket to receive comments from interested persons, including the undersigned Public Representative, on a Postal Service Notice of its entering into an additional Inbound Multi-Service Agreement with a Foreign Postal Operator.[2] The Notice concerns the inbound portion of a bilateral agreement with China Post (China Post 2013 Agreement), which includes rates for the delivery of inbound International Express Mail (EMS), air parcels, and surface parcels from China to the United States. It also includes rates for a "yet to be launched inbound product". The Notice specifies that the Postal Service and China Post Group "must enter into a written modification to the China Post 2013

[1] Notice and Order Concerning Additional Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 Negotiated Service Agreement (with China Post), November 30, 2012 (Order No. 1562).
[2] Notice of United States Postal Service of Filing Functionally Equivalent Inbound Competitive Multi-Service Agreement with a Foreign Postal Operator, CP2012-23, November 30, 2012. (Notice).

Agreement, subject to various entities, including the Commission, before launching this product". Notice at 4. The Postal Service intends for the China Post 2013 Agreement to take effect on January 1, 2013, and to remain in effect for one year unless terminated earlier. Notice at 3.

On September 29, 2010, in Order No. 546, the Postal Regulatory Commission added the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product to the Competitive Product List.[3] The Commission ordered that the Strategic Bilateral Agreement between the United States Postal Service and Koninklijke TNT Post BV and TNT Post Pakketservice Benelux BV (TNT Agreement) (CP2010-95) be part of the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product. *Id.* The Commission also ordered the TNT Agreement be "the baseline agreement for functional equivalency analyses of the Inbound Competitive Multi-Service Agreement with Foreign Postal Operators 1 product." *Id.* On September 16, 2011, the Postal Service filed a Notice seeking to add to the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product an agreement with China Post Group (China Post 2012 Agreement), which included inbound EMS, air parcels and surface parcels.[4] The instant China Post 2013 Agreement would replace the China Post 2012 Agreement, which expires on December 31, 2012. Notice at 3.

In its Notice, the Postal Service seeks to include the China Post 2013 Agreement as part of the Inbound Competitive Multi-Service Agreements with Foreign Postal

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[3] PRC Order No. 546, Order Adding Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 to the Competitive Product List and Approving Included Agreement, Docket Nos. MC2010-34 and CP2010-95, September 29, 2010 (Order No. 546).

[4] Notice of United States Postal Service Filing Functionally Equivalent Inbound Competitive Multi-Service Agreement with a Foreign Postal Operator, CP2011-68, August 16, 2011. (Notice of China Post 2012 Agreement).

Operators 1 product. It asserts that the agreement is functionally equivalent to the TNT Agreement in MC2010-34 and further maintains that it is compliant with 39 U.S.C. §3633 based on supporting documentation filed with the Commission.[5] 39 U.S.C. §3633 (a) requires that competitive products are not subsidized by market dominant products, cover their attributable costs, and collectively cover what the Commission determines to be an appropriate share of the institutional costs of the Postal Service. In 39 C.F.R. §3015.7 (c), the Commission determined this percentage to be 5.5%. The Commission reconfirmed this percentage in Order No. 1449.[6]

COMMENTS

The Public Representative has reviewed the Postal Service's Notice and supporting documentation, including the unredacted China Post 2013 Agreement and the financial work papers filed under seal with the Notice. The Public Representative has also carefully reviewed previous filings and Orders related to this Notice as well as the provisions of 39 U.S.C. §3633. The Postal Service should be lauded for its initiative in pursuing bilateral agreements that will stimulate volume growth in competitive products, provided that such volume growth contributes to the Postal Service's overall financial growth. The provisions of the China Post 2013 Agreement that promote service quality improvements through a pay-for performance system and day-certain service guarantees to and from some countries for EMS will also serve to strengthen options for consumers and the Postal Service's competitiveness in this market.

[5] The supporting documentation included a copy of the financial worksheets, an unredacted copy of the China Post 2013 Agreement, a certified statement required by 39 C.F.R. §3015.5(c)(2), a redacted copy of Governors' Decision No. 10-3, and An Application for Non-Public Treatment of redacted material.

[6] PRC Order No. 1449, Order Reviewing Competitive Products' Appropriate Share Contribution to Institutional Costs, Docket No. RM2012-3, August 23, 2012.

Based upon her review of the financial work papers filed by the Postal Service under seal[7], however, the Public Representative has several serious methodological and consequent legal concerns with the instant China Post 2013 Agreement. The Public Representative further recommends that the Commission require the Postal Service to make these methodological changes and request clarification of certain costs used before a final Order is issued

Even using the methodology in the financial work papers submitted by the Postal Service, the Public Representative finds that the instant agreement could run a substantial risk of not meeting the cost coverage requirements of 39 U.S.C. §3633. Applying the recommended changes to the methodology, unfortunately, will likely worsen the financial outcome and make the agreement inconsistent with the cost coverage requirements of 39 U.S.C. §3633. These concerns are explained below.

Methodological concerns. As indicated above, the China Post 2013 Agreement includes not only rates for inbound EMS, air parcel post and surface post, but also for a "yet to be launched inbound product". Notice at 4. In its Notice, the Postal Service points out appropriate provisions of the agreement that require the Postal Service and China Post Group to "enter into a written modification of the agreement, subject to various entities, including the Commission, before launching this product." Notice at 4. The Public Representative sees no problem with laying down this placeholder for a future modification to the agreement. There is a concern, however, with the inclusion of this "yet to be launched inbound product", for which very little information is provided in the Notice or in the agreement, as part of the calculations for the agreement's overall

[7]CP2013-23, China_Comp_Workpapers (financial work papers)

cost coverage, along with EMS, inbound air parcels and inbound surface parcels. It appears to be technically inappropriate to include in the cost coverage calculations a product for which the Postal Service is admittedly not seeking approval as part of its Notice. Therefore, all cost, volume and revenue data for this new product should be eliminated from the cost coverage calculations.

While a new product yet to be launched should not be included in the cost coverage calculations, it is worth noting for the Commission some questions on the cost and volume information used in the financial work papers for this new product. These questions may be best reserved for the Postal Service's formal filing of the product with the Commission. First, the Commission may want to ask the Postal Service the basis of the 2013 volume assumption for this product, particularly given the lack of information about this product. Second, the unit delivery cost for this new product in cell Bb of worksheet 05_Product_Unit_Cost_Inputs in the financial work papers seems rather low when compared to delivery costs for inbound EMS, air parcels and surface parcels in cells Ba, Bc and Bd of the same worksheet. It appears that the Postal Service may have only used the cost for delivery confirmation, but no other costs that seem to apply to EMS, air parcels and surface parcels.

Next, the per unit processing, delivery and other costs for EMS in cells Aa, Ba and Ca of worksheet 05_Product_Unit_Cost_Inputs of the financial work papers reflect unit costs for EMS from all countries, developing and industrialized, minus one. For air and surface parcels, however, the Postal Service uses per unit processing, delivery and other cost data specific to inbound air and surface parcels from developing countries only taken from the FY2011 International Costs and Revenue Analysis (ICRA).[8] The per unit cost data for developing countries is more refined and appropriate. It is also available for EMS and should EMS therefore be used.

Next, the Commission may want to ask the Postal Service a question regarding the calculation of the per unit delivery cost for EMS in cell Ba of worksheet 05_Product_Unit_Cost_Inputs in the financial work papers. This cost reflects total EMS costs (minus one country) divided by total EMS volume (minus one country) plus total EMS costs for developing countries divided by EMS volume for developing countries. As the total EMS costs and volume (minus one country) already include EMS costs and volumes for developing countries such as China, it is not clear why developing country costs and volumes are included twice in the calculation.

Another serious concern is the exclusion of EMS pay-for-performance penalties from the Postal Service's financial model. In the most recent past, the Postal Service incurred delivery payment penalties from members of the EMS Cooperative and Kahala Group, such as China, for failure to meet set standards for the transmission of tracking data. The Postal Service's financial model included no EMS pay-for-performance penalties and assumed that the Postal Service would receive 100% of payment for each EMS item received for China, even though the EMS Cooperative pay-for-performance system is being applied.

Lastly, in its financial model, the Postal Service makes 2013 volume assumptions for inbound EMS, air parcels and surface parcels from China based on 2012 volumes.

[8] ICRA-FY11, USPS-FY11-NP2, Docket No. ACR2011, December 29, 2011, Reports.xls file, "CRA Staging" tab, (Developing Country Costs)

In light of recent volume trends from the Asia Pacific region and China in particular, the appropriateness of these assumed 2013 volumes is questionable. The Public Representative therefore strongly encourages the Commission to take a careful look at the comparative volume weightings of each product in the agreement and the cost coverage of each product in order to assess the financial impact of future volume growth and decline on the agreement's total cost coverage.

Functional Equivalency. Based upon her review, the Public Representative concludes that the 2013 China Post Group Agreement is functionally equivalent to the TNT Agreement in terms of the products being offered and the contract's cost characteristics. The Postal Service does identify some differences between the two agreements, but these differences do not impact any cost or market characteristics that would differentiate the two agreements at any substantive level. Notice at 5 and 6.

39 U.S.C. §3633 (a). As previously indicated, 39 U.S.C. §3633 (a) requires that competitive products are not subsidized by market dominant products, cover their attributable costs, and collectively cover what the Commission determines to be an appropriate share of the institutional costs of the Postal Service. Following a careful review of the financial work papers with the methodology submitted by the Postal Service in its filing, the Postal Service has demonstrated that the instant agreement will meet the criteria of 39 U.S.C. §3633. The Postal Service has used a cost contingency in its calculations to account for changes in costs and changes in exchange rates during 2013. Any minor cost increase or exchange rate fluctuation beyond the contingency, however, as well as a shift in the volume assumptions, will easily make the agreement inconsistent with the cost coverage requirements of 39 U.S.C. §3633.

Furthermore, the Public Representative does not believe the Postal Service's methodology is appropriate. More specifically, the Public Representative believes that (1)the new product yet to be launched should not be used in the cost coverage calculations; (2) the EMS per unit delivery, processing and other costs for developing countries found in the ICRA-FY11 should be used in the calculations versus the total unit costs that apply to developing *and* industrialized; and (3) a reasonable assumption of pay-for performance penalties should be included in the financial model based on penalties the Postal Service received in calendar year 2011 for missing or untimely tracking data as per its 2011 EMS Cooperative Report card.

The Commission should be aware that this first modification to the methodology alone would make the agreement consistent with 39 U.S.C. §3633, but by a highly risky margin and assuming no other changes in costs, exchange rates or volumes. The second methodological change alone would make the agreement inconsistent with 39 U.S.C. §3633 as the EMS average per unit processing, delivery and other costs for developing countries are higher than the average costs for industrialized *and* developing countries combined. The third methodological change alone would also likely make the agreement inconsistent with the requirements of 39 U.S.C. §3633 in light of the payment penalties applied in the EMS pay-for-performance system, but financial modeling based on the Postal Service's 2011 EMS Cooperative Report Card would need to be conducted before a determination is made.

Application for Non-Public Treatment. The Postal Service includes an Application for Non-Public Treatment as Attachment 4 to its Notice to explain why certain information in its financial work papers, the 2013 China Post Group Agreement, and the Governor's Decision No. 10-3 is redacted and filed non-publicly with the Commission. The Public Representative notes that Business Rules have been added to the agreement in Annex 6 and have been redacted. Notice at 8. The Public Representative has carefully reviewed the Business Rules, as well as the Postal Service's Application for Non-Public Treatment, and does not find any of the information contained in the Business Rules to be commercially sensitive, particularly as it does not include any information related to rates, volumes, costs or revenues. Rather, this information seems to be of a purely operational nature. The Public Representative would therefore suggest that the Commission seek explanation from the Postal Service of its need to make Annex 6 non-public.

The Public Representative provides these comments for the Commission's consideration and hopes that the Commission finds them helpful.

Respectfully submitted,

Allison J. Levy

Public Representative

901 New York Avenue NW Suite 200

Washington, DC 20268-0001

202-789-6848